COPY

FILED
MAY 31 1955
HAROLD B. WILLEY, Cle

IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No. 743

C. RUSSELL FELDMANN, CHARLOTTE M. FELDMANN, JOSEPH V. McKEE, JR., CAROLYN OTTO, PHYLLIS McKEE and BARBARA JANE FELDMANN,

Petitioners,

—against—

JANE PERLMAN, ARTHUR KRAMER, INGER LAWRENCE, MURIEL LAWRENCE, A. CHARLES LAWRENCE, INGER LAWRENCE, MURIEL LAWRENCE, EDITH LAWRENCE and JAMES J. LAWRENCE, as joint tenants with right of survivorship, ISAAC WAGNER and HARRY MERNOFF,

Respondents.

PETITIONERS' REPLY BRIEF IN SUPPORT OF A PETITION FOR A WRIT OF CERTIORARI

ARTHUR H. DEAN,
HOWARD T. MILMAN,
Attorneys for Petitioners,
48 Wall Street,
New York 5, N. Y.

SULLIVAN & CROMWELL,
Of Counsel.

BLEED THROUGH POOR COPY

INDEX

PAGE

Question Presented 2

Statement 2

POINT I:

Feldmann Violated His Fiduciary Duties 12

POINT II:

The Decision Below Rests upon the Facts Found by the District Court or Admitted by Petitioners and upon the Proper Allocation of the Burden of Proof 24

CONCLUSION 28

TABLE OF CITATIONS

American Construction Co. v. Jacksonville, T. & K. W. R. Co., 148 U. S. 372 28

Ballantine v. Ferretti, 28 N. Y. S. 2d 668 (S. Ct., N. Y. Co., 1941) 18, 19

Bigelow v. R. K. O. Radio Pictures, 327 U. S. 251 (1946) 27

Board of Commissioners of Tippecanoe County v. Reynolds, 44 Ind. 509 (1873) 21

Brackenridge v. Holland, 2 Black. (Ind.) 377 27

Brady v. Bean, 221 Ill. App. 279 15

Clarke v. Greenberg, 296 N. Y. 146, 71 N. E. 2d 443 (1947) 15, 21

PAGE

Commonwealth Title Insurance & Trust Co. v. Seltzer, 227 Pa. 410, 76 Atl. 77 (1910) 18

Dale v. Thomas H. Temple Co., 186 Tenn. 69, 208 S. W. 2d 344 (1948) 18

Forbes v. McDonald, 54 Cal. 98 15

Gerdes v. Reynolds, 28 N. Y. S. 2d 622, 30 N. Y. S. 2d 755 (S. Ct., N. Y. Co., 1941) 18, 20

Hamilton-Brown Shoe Co. v. Wolfe Bros. & Co., 240 U. S. 251 (1916) 27
Hill v. Nisbet, 100 Ind. 341 12

Insuranshares Corp. v. Northern Fiscal Corp., 35 F. Supp. 22 (D. C., E. D. Pa., 1940) 17
Irving Trust Co. v. Deutsch, 73 F. 2d 121 (Cir. 2, 1934), cert. den. 294 U. S. 709 ..... 15, 25

Levy v. American Beverage Corp., 265 App. Div. 208, 38 N. Y. S. 2d 517 (1st Dept., 1942) 22

Macht v. Merchants M. & C. Co., 22 Del. Ch. 74 15
Magruder v. Drury, 235 U. S. 106 14
Mayflower Hotel Stock P. C. v. Mayflower Hotel Corp., 173 F. 2d 416 ..... 25n
McClure v. Law, 161 N. Y. 78 15
Meinhard v. Salmon, 249 N. Y. 458 (1928) 16
Moulton v. Field, 179 Fed. 673 (C. A. 7, 1910) 15

Panama R. Co. v. Napier Shipping Co., 166 U. S. 280 28
Pepper v. Litton, 308 U. S. 295 (1939) 12, 23, 25

BLEED THROUGH POOR COPY

PAGE

Porter v. Healy, 244 Pa. 427, 91 Atl. 428 19
Pratt v. Shell Petroleum Corp., 100 F. 2d 833 (C. A. 10, 1938) 16, 25

S. E. C. v. Chenery Corp., 318 U. S. 80 21
Schemmel v. Hill, 91 Ind. App. 373, 169 N. E. 678 ..... 12, 25n
Seagrave Corp. v. Mount, 212 F. 2d 389 (C. A. 6, 1954) 19
Sheldon v. Metro-Goldwyn Pictures Corp., 309 U. S. 390 27

West v. Camden, 135 U. S. 507 15
Wood v. Manchester F. Assur. Co., 54 App. Div. (1st Dept., 1900) 17

Young v. Higbee Co., 324 U. S. 204 (1945) 15, 20, 21
Young v. Potts, 161 F. 2d 597 (C. A. 6, 1947) 15, 21

Zaring v. Kelly, 75 Ind. App. 15, 128 N. E. 657 ..... 25n

BLEED THROUGH POOR COPY

IN THE

Supreme Court of the United States

October Term, 1954

No. 743

J. RUSSELL FELDMANN, CHARLOTTE M. FELDMANN, JOSEPH V. McKEE, JR., CAROLYN OTTO, PHYLLIS McKEE and BARBARA JANE FELDMANN,

Petitioners,

—against—

JANE PERLMAN, ARTHUR KRAMER, INGER LAWRENCE, MURIEL LAWRENCE, A. CHARLES LAWRENCE, INGER LAWRENCE, MURIEL LAWRENCE, EDITH LAWRENCE and JAMES LAWRENCE, as joint tenants with right of survivorship, ISAAC WAGNER and HARRY MERNOFF,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO A WRIT OF CERTIORARI

Petitioners have sought a writ of certiorari to review an interlocutory decision of the United States Court of Appeals for the Second Circuit (Clark and Frank, *JJ.;* Swan, J., dissenting*), which reversed a judgment of the District Court.

The case presents no federal question. Petitioners concede it is governed by the law of Indiana. The Court below held that under Indiana law (which does not differ

* The dissenting judge did not hear the argument. He was substituted several months after the argument, by consent of the parties, when Judge Learned Hand decided to disqualify himself.

from the law in other states) petitioners are liable. Petitioners contend that Indiana law requires a different conclusion, but have produced no cases supporting such contention.

Question Presented

On the facts was the Court below warranted in applying the familiar principle that a corporate fiduciary who uses his corporate power and position for his personal gain to the detriment of the corporation must account for his profits?

Statement

Since petitioners' "Statement" omits reference to the very facts on which the decision of the Court of Appeals rests—the facts showing that petitioner Feldmann, in selling his controlling stock of Newport, sacrificed the interests of Newport—we must supply those facts in their context.

The parties

Respondents (plaintiffs below) own 5,536 shares of stock of Newport.

The principal defendant, petitioner C. R. Feldmann, was during the times in question president, chairman of the board of directors and controlling stockholder of Newport, an Indiana corporation. The other petitioners were members of Feldmann's family. Represented by Feldmann, they participated in the transaction complained of (Findings 65, 73, 64a-65a, 67a*).

---

* References marked with a lower case "a" relate to pages of the Appendix filed by plaintiffs in the Court of Appeals. References marked with a capital "A" relate to the Opinion of the Court of Appeals attached to petitioners' Petition for a Writ of Certiorari.

BLEED THROUGH POOR COPY

Feldmann and his family at the time of the commencement of the transaction held 33% of Newport's outstanding shares. The remaining shares—over 735,000—were widely distributed among several thousand stockholders (Findings 6-9, 45a-46a).

Nature of Newport's business and needs

Newport in 1950 was engaged chiefly in the production of steel. Originally a phonograph and radio company, it had first entered the steel business in 1946, buying an old steel mill "capable only of high cost operation" (Finding 21, 49a). During the succeeding years Newport had gradually enlarged and improved its steel facilities. The development of Newport as a steel producer had been made possible by the periodic and extreme steel shortages during the post-war years. Newport (under Feldmann's management) had used the shortages to obtain large interest-free loans and substantial premiums from customers needing steel in their business; in return therefor Newport undertook to deliver to these customers large quantities of its steel output over extended periods at the prices prevailing at the time of delivery. This cost-free method of raising funds for improving facilities in time of steel shortage in return for commitments to sell steel became known and widely used in the steel industry under the name "Feldmann Plan" (Finding 44, 57a-58a).

During the period from 1946 to 1949 Feldmann had on eleven occasions successfully negotiated such interest-free advances and premiums for Newport in return for commitments of its steel production. These advances to Newport aggregated $13,510,000 (Findings 38-40, 55a-77a). They constituted the principal source of the funds with which Newport paid for its steel manufacturing facilities.

In August 1950, Newport's steel facilities were still so marginal, inadequate and unintegrated that only in times of extreme shortage could it hope to make a profit. Its costs of production were greater than those of its competitors. In normal times sale of its steel was feasible only in the local area where freight considerations might balance off higher costs (Findings 34, 54a). Moreover, Newport's steel production consisted chiefly of "hot rolled" sheets and coil, a type of steel that was being replaced in the industry by the finer "cold rolled steel"—which required further processing of the hot rolled product (Findings 21-23, 32, 45, 49a-51a, 53a, 58a, 116a, 130a; Pl. Ex. 38, 180a-181a). The trial Court found that with existing facilities there was "scant ground for inference of profits from the steel division under any conditions other than those of an outright boom" (Op. 42a).

Newport's opportunity of competing successfully when normal times returned depended upon improving its steel product through the acquisition of "cold rolling" facilities to further process the hot rolled steel it produced (Pl. Ex. 38, 179a-180a).

Since Newport had no funds to buy cold-rolling equipment (Findings 46, 58a), it engaged from May to July 1950 in merger negotiations with another steel company which owned a cold-rolling mill. With the beginning of the Korean hostilities (June 25, 1950) Feldmann's attitude toward the merger cooled, and he suspended the merger talks in July 1950 (Finding 47, 58a-59a).

Steel shortage resulting from Korean hostilities

The outbreak of the Korean conflict created an extreme steel shortage (Findings 109, 78a). "Steel producers were in a position to exact for their product from hungry end

BLEED THROUGH POOR COPY

users of steel a price premium over and above prices fixed on the basis of their mill costs" (Op. 18a). No legal limitation on steel prices existed in 1950 (Op. 18a). While most domestic steel producers adhered to their own published prices *on ordinary sales*, the amount of steel they were willing to sell in this manner to civilian users was inadequate to their needs.

This renewal of the post-war steel shortages prepared the soil for renewing the use of "Feldmann Plan" financing. Newport was in a favorable position to obtain funds on this basis, for only a third of its expected production was committed (Finding 79, 69a). During this very period, to Feldmann's knowledge, several of the most reputable steel producers obtained from customers large interest-free "Feldmann Plan" loans on favorable terms to be used in improving their steel facilities, in return for committing part of the steel production to these customers (Finding 86, 71a).

After the beginning of the Korean hostilities, Feldmann admittedly made no effort to find out what could be done for Newport along the lines of raising funds to improve Newport's steel facilities by the use of Feldmann Plan financing (Finding 88, 71a). Instead, Feldmann, his family and fellow directors undertook a final, self-serving transaction, which the Court of Appeals correctly characterized as "siphoning off for personal gain corporate advantages to be derived from a favorable market situation" (A-8).

Deal with the Wilport group

In August 1950 Feldmann had a three-fold fiduciary responsibility to Newport; he was president, director and controlling stockholder of the company. While serving in

those fiduciary roles, Feldmann for a private consideration transferred Newport's entire uncommitted steel supply to a distant group of end users (Wilport), who during the shortage needed steel for their personal use. Since the Wilport group were paying to obtain steel for their immediate personal use, Feldmann's act terminated the possibility of deploying Newport's uncommitted steel supply for the corporate benefit either by obtaining Feldmann Plan interest-free loans needed for acquiring cold rolling facilities or by building up good will in the area where in normal times Newport might hope to compete (see A-9–A-10; Findings 34, 53, 91, 92, 54a, 61a, 72a).

Feldmann's transfer of Newport's steel in short supply was *not* made in the exercise of a disinterested fiduciary discretion. He was paid handsomely for his sacrifice of the corporation's interests, as the following facts show:

On August 24, 1950 Feldmann undertook to transfer control of Newport and its steel supply—including its entire board of directors—on payment of $20 per share for the block of shares which he controlled (Finding 65, 65a). The price of $20 per share was more than twice the market when the deal was negotiated, and twice what the stock had ever before sold for (see *infra* p. 9). The total payment received by Feldmann ran to about $8,000,000.

Feldmann expressly undertook in writing "to deliver * * * the resignation of all members of the board of directors of Newport" (Pl. Ex. 4, 158a), and the oral understanding (as the trial Court found) was that he would procure the election of the purchasers' nominees (Op. 27a; Finding 64, 64a).

"The immediate resignation of the officers and directors of Newport," as the trial Court expressly found, "was im-

BLEED THROUGH POOR COPY

portant to the purchasers of Feldmann's stock, in order to make available to themselves as soon as possible the maximum amount of steel from Newport" (Finding 84, 70a; see also Finding 70, 66a).

Before the closing, the original purchasing group enlarged its membership to sixteen, raising the required fund to pay Feldmann by an agreement to apportion among the participants calls upon Newport's uncommitted steel supply in precise proportion to the amount which each contributed to buy out Feldmann (Finding 68, 65a-66a; Pl. Ex. 10, 170a).

As stated by the representative of the purchasing group, the availability of steel to the members of the group "was the *one* thing that motivated the interest in investing $8,000,000 or more" to buy out Feldmann (100a-101a).

The District Court found (Finding 53, 61a):

> "53. The dominant motive of the purchasing group in seeking to purchase Feldmann's controlling stock interest in Newport was to obtain a continuing source of steel supply. Feldmann knew during the negotiations that such was their motive."

In the preliminary negotiations Feldmann used his position as president to have employees of Newport make available to representatives of the proposed purchasing group confidential corporate data as to existing steel commitments and their expiration dates, and even had the plant manager prepare and turn over a schedule of Newport's uncommitted steel production for the year 1950.

The purchasing group consisted of manufacturers with plants remote from Newport; none was within the 150-mile area that would make it a natural customer of Newport in

normal times, and some were as far as 750 miles away (Findings 23, 34, 92, 50a, 54a, 72a). Their only possible interest in Newport was to obtain steel during the period of shortage when they could not secure sufficient steel from their normal suppliers.*

To make the maximum profit from the transaction, and since the agreement gave Feldmann the right to have the purchasers take up to 400,000 shares, Feldmann caused his family to make additional purchases on the market and from certain friends (Finding 96, 73a; 107a-108a).

Feldmann testified that these friends asked him to fix a "fair price" for the Newport shares which Feldmann proposed to purchase. As to the shares of two of these friends he fixed the fair price as $10 per share. But as to a third friend who was one of the directors, and whose resignation he required to put through the deal, Feldmann fixed the price as $12 per share (Findings 98, 74, 74a, 67a).

All of these shares, title to which was taken in the name of Feldmann's family and associates, Feldmann turned over to the buying group a couple of days later for $20 per share (109a-110a). Feldman's own conduct thus shows that he regarded Newport stock—as stock—to have a fair value of no more than $10 per share.

On the closing Feldmann provided the resignation of all officers and directors. This was handled in such a manner that as each director resigned a new director nominated by the purchasing group was successively elected. Feldmann was the last director to resign and voted for all the

---

* Petitioners themselves admit that the Wilport group disposed of their stock in Newport as soon as the steel shortage ended (Pet. p. 4). This was foreseeable and was predicted by respondents at the trial.

BLEED THROUGH POOR COPY

directors supplied by the purchasing group except the director who replaced him (Finding 74, 67a-68a).

That the purchasers' sole interest was to obtain steel for themselves was further made clear by the fact that they required from Feldmann no warranty or representation of Newport's financial condition but only a warranty as to Newport's steel commitments (Finding 70, 66a).

Feldmann admitted his realization that the purchasing group was "interested in buying stock in order to obtain a source of steel supply" (Finding 53, 61a, 104a), that his price would not have been paid by "one not interested in securing a source of steel supply," and that *he considered the price "a combination of both factors, investment value and ability to obtain a source of steel supply"* (105a).

The price paid Feldmann was more than twice the "broad, fair and active market" on which the trial Court found the stock had been selling at the time of the agreement. It was more than twice what the stock had ever sold for before, and twice what Feldmann had fixed as the "fair price" for the shares his friends sold to his family. The $20 price was also more than twice any valuation that could be reached by capitalizing Newport's profits on the price-to-earnings ratio at which far superior steel companies like U. S. Steel, Bethlehem Steel, and Republic Steel were currently selling on the New York Stock Exchange (Pl. Ex. 18; Findings 6, 8, 96, 98, 45a, 46a, 73a, 74a, 117a-118a, 137a-140a; Pl. Ex. 30, 175a; Defts. Ex. 54, p. 1, 190a-191a).

The transfer of control of Newport's management and steel supply was carried out without notice to the stockholders. By this transaction Feldmann vested control of Newport's steel supply in a group which he knew to be committed to the application of such steel supply for their own

private purposes during the shortage. He thereby deprived the corporation of a management which could disinterestedly consider what use could best be made by the corporation of its temporarily favorable economic position, and diverted to his private profit corporate rights and advantages.

Subsequent events

Petitioners have gone outside the record to call attention to the fact that during the pendency of the appeal the Wilport Company sold its shares to Merritt-Chapman & Scott Corporation (Pet., p. 4).

It should be noted that by this sale, which occurred at the end of 1953, the Wilport group (1) immediately upon the end of the steel shortage hastened to rid itself of its Newport stock; (2) could get for its 37% control block only the equivalent of about $10 per share (approximately the then market price), or half of what they had paid Feldmann; and (3) did not receive a higher per share price for their control block than what Merritt-Chapman by the same agreement offered simultaneously to all other stockholders of Newport.*

This confirms—what was fully established at the trial—that what Feldmann got in excess of the market was paid not because his stock was worth more, but because he exacted a premium as a price for making Newport's steel available during the shortage to a group of steel-hungry end-users.

---

* This appears from a Prospectus filed with the Securities and Exchange Commission and sent in January 1954 to all stockholders.

BLEED THROUGH POOR COPY

Petitioners' misconception of the decision of the Court of Appeals

In an effort to whet this Court's interest, petitioners take extravagant liberties both with the authorities and with the opinion below, stating (Pet., p. 3):

> "The Court of Appeals has held, contrary to every court decision on the question, that corporate stock and the voting rights appurtenant thereto are not the sole property of the stockholder who owns the stock. It held that when the number of shares owned is sufficient to control the corporation and control is valuable, a controlling stockholder who sells his outstanding stock must share with the other stockholders that part of the sales price which represents the value of control."

As if to prevent any such distortion of its holding, the Court of Appeals said in plain language, after pointing out how Feldmann had misused his position to the detriment of the corporation and turned a corporate advantage into a private profit:

> "We do not mean to suggest that a majority stockholder cannot dispose of his controlling block of stock to outsiders without having to account to his corporation for profits or even never do this with impunity when the buyer is an interested customer, actual or potential, for the corporation's product. But when the sale necessarily results in a sacrifice of this element of corporate good will and consequent unusual profit to the fiduciary who has caused the sacrifice, he should account for his gains. So in a time of market shortage, where a call on a corporation's product commands an unusually large premium, in one form or

another, we think it sound law that a fiduciary may not appropriate to himself the value of this premium. Such personal gain at the expense of his co-venturers seems particularly reprehensible when made by the trusted president and director of his company" (A-11).

The Court therefore held that "to the extent that the price received by Feldmann and his co-defendants included such a bonus, he is accountable" (A-11).

POINT I

Feldmann violated his fiduciary duties.

1. It is elementary that Feldmann, as the chief executive, director and controlling stockholder of Newport, stood in a fiduciary relation to the corporation. *Pepper* v. *Litton,* 308 U. S. 295, 306, 311 (1939). Each of these three positions made Feldmann a fiduciary; their combination in his hands gave him nearly untrammeled powers over Newport's fate, accentuating the strictness of his responsibilities. His was an obligation of "absolute and most scrupulous good faith"; he could not, "in any degree, allow his official conduct to be swayed by his private interest, which must yield to official duty." "Directors of a business corporation act in a strictly fiduciary capacity. Their office is a trust." (*Schemmel* v. *Hill,* 91 Ind. App. 373, 169 N. E. 678, 682-3; *Hill* v. *Nisbet,* 100 Ind. 341, 353.)

As stated in *Pepper* v. *Litton,* 308 U. S. 295:

> "A director is a fiduciary. *Twin Lick Oil Co.* v. *Marbury,* 91 U. S. 587, 588. So is a dominant or controlling stockholder or group of stockholders. *Southern Pacific Co.* v. *Bogert,* 250 U. S. 483, 492. *Their powers are powers in trust* (p. 306). (Italics ours.)

BLEED THROUGH POOR COPY

> "* * * He who is in such a fiduciary position cannot serve himself first and his *cestuis* second. * * * He cannot use his power for his personal advantage and to the detriment of the stockholders and creditors no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements. For that power is at all times subject to the equitable limitation that it may not be exercised for the aggrandizement, preference, or advantage of the fiduciary to the exclusion or detriment of the *cestuis*" (p. 311).

In Indiana, as elsewhere, "the responsibility of the fiduciary is not limited to a proper regard for the tangible balance sheet assets of the corporation, but includes the dedication of his uncorrupted business judgment for the sole benefit of the corporation, in any dealings which may adversely affect it" (Clark, *J.*, A-7). That such was the measure of Feldmann's duties was recognized even in Judge Swan's dissenting opinion below (A-12).

Against this legal background, the facts inevitably spell Feldmann's liability. The steel shortage occasioned by the outbreak of the Korean conflict afforded Newport valuable opportunities for gain, either by resuming its traditional policy of Feldmann plan financing (which at that very time was being utilized by several other reputable steel companies) or by building customer good will within the geographical area in which freight savings might, upon the return of a normal market, enable it to compete with the low cost product of other steel producers. "Either of these opportunities was Newport's, to be used to its advantage only" (Clark, *J.*, A-10). Had Feldmann, in the exercise of disinterested business judgment, refrained from embracing these opportunities, he might have been within

his rights. But Feldmann's judgment was corrupted by the promptings of self-interest. Instead of exploring the possibilities of new Feldmann plan financing, he utilized the opportunities offered by the steel shortage for his own benefit through the device of selling his control stock, at a premium price, and immediately transferring management to buyers whose predetermination to take Newport's product for themselves precluded any hope for Newport to turn those opportunities to its own advantage. In effect, he sold a call on Newport's steel supply (A-11). By thus sacrificing Newport's rights and opportunities for his private gain, Feldmann acted in the teeth of his fiduciary duties. It is this breach which renders him accountable.

2. Petitioners urge the absence of proof that Newport's loss of these opportunities resulted in computable damage. But damage to the *cestui* is not a necessary element of fiduciary accountability. Once the breach of fiduciary duties is established—as it is here—it is fundamental that the fiduciary must account for the profits derived from his breach, no matter whether or not his *cestui* has sustained a demonstrable pecuniary loss. *Magruder* v. *Drury*, 235 U. S. 106, 119-120:

> "It is a well-settled rule that a trustee can make no profit out of his trust. The rule in such cases springs from his duty to protect the interest of the estate, and not to permit his personal interest to in any wise conflict with his duty in that respect. * * * It makes no difference that the estate was not a loser in the transaction."

This principle has been applied in a variety of situations involving corporate fiduciaries.

Thus if a corporate director accepts pay for resigning or for appointing a successor in office, the corporation is en-

BLEED THROUGH POOR COPY

titled to an accounting for the amount received, regardless of any injury resulting. *West* v. *Camden,* 135 U. S. 507 (1890); *McClure* v. *Law,* 161 N. Y. 78 (1899); *Forbes* v. *McDonald,* 54 Cal. 98 (1880).

A stockholder accepting payment for casting his vote or for giving his proxy is accountable to the corporation although it suffered no loss. *Macht* v. *Merchant M. & C. Co.,* 22 Del. Ch. 74, 80 (1937); *Brady* v. *Bean,* 221 Ill. App. 279, 283-4 (1921).

In *Moulton* v. *Field,* 179 Fed. 673 (C. A. 7, 1910), the directors of an insurance company permitted one Gray, who held a management contract with the corporation, to sell that contract to a third party for $125,000. Although there was no corporate loss, the directors were held liable (p. 675):

> "If the succession was worth $125,000 in the market, the sale * * * should have been made by the directors for the benefit of the owners of the business, not of Gray."

A stockholder bringing a derivative action occupies a fiduciary relation to the corporation and the other stockholders. If he settles the case by selling his stock at a premium, he is accountable for that premium, no matter whether the action could have been successful. *Clarke* v. *Greenberg,* 296 N. Y. 146 (1947); see *Young* v. *Higbee Co.,* 324 U. S. 204 (1945); *Young* v. *Potts,* 161 F. 2d 597 (C. A. 6, 1947).

The rule that proof of corporate damage is no prerequisite of fiduciary liability has been consistently applied in those cases where directors diverted corporate rights or opportunities to themselves. In *Irving Trust Co.* v. *Deutsch,* 73

F. 2d 121 (C. A. 2, 1934), cert. den. 294 U. S. 709, corporate directors who bought stock for themselves rather than for the corporation were held accountable for their profits even though they acted in good faith and there was proof that the corporation did not have the financial means to acquire the stock itself. In *Pratt* v. *Shell Petroleum Corp.*, 100 F. 2d 833 (C. A. 10, 1938), a corporation engaged in the business of acquiring oil leases employed the defendant as a geologist; the defendant, having acquired oil leases for himself, was held accountable:

> "It was not necessary for plaintiff to show that it suffered detriment, injury or damage. * * * a court of equity does not concern itself with the question whether * * * the principal suffered actual injury" (100 F. 2d, at 837-8).

The Court below was therefore fully justified in holding that "The corporate opportunities of whose misappropriation the minority stockholders complain need not have been an absolute certainty in order to support this action against Feldmann. If there was possibility of corporate gain, they are entitled to recover" (A-8).

3. Petitioners in effect argue that the fiduciary principle, however broad and sweeping, is subject to an exception if the fiduciary sells stock, *i.e.* that, where the fiduciary is in a position of absolute control (as chief officer, dominating director and dominant stockholder), he is exempted from equitable principles provided he siphons off the profit by the device of a sale of his control block and transfer of management.

The fiduciary rule of undivided loyalty cannot thus be undermined by "the disintegrating erosion of particular exceptions" (Cardozo, *J.*, in *Meinhard* v. *Salmon*, 249 N. Y.

BLEED THROUGH POOR COPY

458, 464 [1928]). It is true, of course, that in *ordinary circumstances* the sale by a director to another of corporate stock will not affect the corporate interests; the transaction then offers no occasion for invoking the fiduciary principle. But the rule is otherwise where—as here—the sale of a large block of stock at an excessive price is a device for transferring what belongs to the corporation and impairs the interests of the corporation. If the seller of such stock stands in a fiduciary role as director and controlling stockholder, reason and authority require that he be held accountable. That the transaction is effected through a stock sale does not relieve the fiduciary of liability; *Wood* v. *Manchester Fire Ass. Co.*, 54 App. Div. 522, 523-4 (1st Dept., 1900):

> "* * * shareholders have the right to sell their stock, and at any stockholders' meeting to vote and act in the interest and protection of their own pecuniary requirements. * * * But when a stockholder accepts the trusteeship of a corporation, and becomes director and president, the freedom of his right of action as a stockholder is fettered by the lines of his trust duty. It is a voluntary thing for him to assume such a position, but, once accepted, paramount duties flow from the responsibility which he takes."

The rule finds its most elementary application where a fiduciary for a consideration sells stock and transfers directorates with notice that the purchasers are interested in diverting the corporate assets to themselves. The seller must then account for the corporation's damage as well as his own profits. *Insuranshares Corp.* v. *Northern Fiscal Corp.*, 35 F. Supp. 22, 25 (D. C., E. D. Pa., 1940):

> "Those who control a corporation * * * owe some duty to the corporation in respect of the transfer of

the control to outsiders. The law has long ago reached the point where it is recognized that such persons may not be wholly oblivious of the interests of everyone but themselves, even in the act of parting with control * * * "

Accord:

Gerdes v. *Reynolds*, 28 N. Y. S. 2d 622, 30 N. Y. S. 2d 755 (S. Ct., N. Y. Co., 1941);
Ballantine v. *Ferretti*, 28 N. Y. S. 2d 668 (S. Ct., N. Y. Co., 1941);
Dale v. *Thomas H. Temple Co.*, 186 Tenn. 69, 208 S. W. 2d 344 (1948).

The corporate wrong arising from the device of a sale of control stock may take forms less obvious and blatant than the outright looting of corporate assets by the purchasers. Thus in *Commonwealth Title Ins. & Trust Co.* v. *Seltzer*, 227 Pa. 410, 76 Atl. 77 (1910), the defendant, president of a corporation, was approached by another organization wishing to acquire the corporate real estate. The defendant, together with another director, arranged for the sale of their control block of stock at a substantial profit. Having obtained control, the purchaser then bought the real estate from the corporation at a price "which was found not to be inadequate" (227 Pa., at 415). Nevertheless, the court held the sellers accountable for the profits derived from the stock sale (227 Pa., at 416-7):

"These defendants as managing officers were under an inherent obligation not to in any manner use their positions to advance their individual interests as distinguished from the interests of their corporation. When the president of this corporation was approached by a likely buyer, * * * he should have overlooked his

BLEED THROUGH POOR COPY

> own welfare and acted entirely for the benefit of his corporation. * * * In scrutinizing the acts of such officers, the Court will not heed mere form when the substance that lurks behind them shows profits from a dealing in the corporation property."

In *Seltzer* then, the sale of control stock did not result in demonstrable injury to the corporation or in the looting of its assets. The purchasers of the control stock bought the corporation's real estate at an adequate price. But the sale of the control stock by the corporation's fiduciary prevented the corporation from utilizing its bargaining power to its full extent; and that was enough to make the fiduciary accountable for his profit. The analogy of *Seltzer* to the case at bar requires no elaboration. Here, too, the buyers of Feldmann's control stock did not loot Newport's assets; for the steel they diverted from Newport they paid mill prices—which they themselves fixed. But Feldmann's sale necessarily foreclosed Newport from the opportunity of deriving benefits offered by the 1950 steel shortage. Since Feldmann cut off Newport's opportunity, and, to the exclusion of the other stockholders, turned Newport's steel supply to his private benefit through the sale of management, he must account for his resulting profits.

In *Porter* v. *Healy,* 244 Pa. 427, 91 Atl. 428, 432, where a special payment was made in connection with a stock sale, for transfer of directors, the court held that the sellers must account for so much as was paid them for transferring control rather than for their stock. See also *Seagrave Corp.* v. *Mount,* 212 F. 2d 389, 396-7 (C. A. 6, 1954).

In *Ballantine* v. *Ferretti,* 28 N. Y. S. 2d 668, 680, where the controlling stock was sold with the immediate substitution of directors, the court held that the fiduciaries must account for so much of the price they received as exceeded

the fair price of the stock as stock, even though the corporation whose control was transferred was in no way damaged. Accord: *Gerdes* v. *Reynolds,* 30 N. Y. S. 2d 755, at 779.

There is no lack of additional instances in which the sale of corporate stock was held to render the seller accountable for his profits, despite the lack of demonstrable damage to the corporation. Thus, a stockholder who has brought a derivative action or similar proceeding on behalf of his corporation or his co-stockholders, is free to sell his stock although the sale will terminate his right to maintain the action. But in selling his stock the stockholder-plaintiff cannot, under the guise of getting a higher price for the stock, accept a premium for the surrender of the action which he brought in the right of the corporation or the other stockholders. If he does, he must account for the premium, even though there is no proof at all that the action could ever have been successful.

This court so held in *Young* v. *Higbee Co.,* 324 U. S. 204 (1945), where Black, *J.* wrote (pp. 212-3, note 12):

> "By virtue of their standing as sole appellants, Potts and Boag, during the pendency of the appeal dominated the fate of the reorganization as completely as though they had been the majority stockholders of a going corporation. Cf. *Southern Pacific Co.* v. *Bogert,* 250 U. S. 483, 492: ' * * * The essential of the liability to account sought to be enforced in this suit lies not in fraud or mismanagement, but in the fact that, having become a fiduciary through taking control of the old Houston Company, the Southern Pacific has secured fruits which it has not shared with the minority.' " (Italics ours.)

BLEED THROUGH POOR COPY

Accord:

Clarke v. *Greenberg,* 296 N. Y. 146, 71 N. E. 2d 443 (1947);
Young v. *Potts,* 161 F. 2d 597 (C. A. 6, 1947).

We submit that Feldmann was properly held accountable for the gain he derived by sacrificing Newport's opportunities. It is no defense that the transaction by which Feldmann achieved his ends was cast in the form of a stock sale.

4. None of petitioners' arguments can detract from this conclusion.

a) Petitioners invoke *S. E. C.* v. *Chenery Corp.,* 318 U. S. 80. The question in that case was simply whether the directors were prohibited from *buying* outstanding stock, in the absence of fraud or overreaching. Of course the Court below fully recognized the principle there stated that stockholders are not precluded "*merely* because they are officers and directors, from buying and selling the corporation's stock." But what was here involved was not a mere stock sale. In such a situation, as shown by the later case of *Young* v. *Higbee Co.,* 324 U. S. 204, the fact that the violation of a fiduciary duty is effected through the device of a stock sale does not relieve the fiduciary of accountability.

b) Petitioners rely on *Board of Commissioners of Tippecanoe County* v. *Reynolds,* 44 Ind. 509 (1873). The case is wholly beside the point. The defendant there, a director, bought stock from the plaintiff without revealing facts known to him regarding the financial condition of the company. In an action which the seller brought in his individual capacity, the Court held that the defendant was not guilty of actionable deceit. There was no claim or proof

that there had been a breach of duty to the corporation; the transaction had resulted in no detriment to the corporation; and the Court drew a sharp distinction between an individual suit for an alleged fraud on an individual stockholder and a wrong to the corporation or the stockholders as a group. While denying a fiduciary relation in the former case, the Court emphasized, "Where the action of the directors has affected the whole body of stockholders, the relation of trustee and cestui que trust has been held to exist" (p. 513). In the case at bar, the duties breached by Feldmann were those which he owed to Newport or the whole body of stockholders, not to any one individual.

Petitioners also cite *Levy* v. *American Beverage Corp.*, 265 App. Div. 208, 38 N. Y. Supp. 2d 517 (1st Dept. 1942). There a majority block of stock was sold above the market (but at a price less than what the seller had himself paid and less than current book value). The Court expressly found that there had been no agreement to secure resignation of directors and no change of directors occurred, except by vote of the new majority at the next regular stockholders' meeting, and further found that the defendant had had neither knowledge nor notice of any threatened detriment to the corporation.

In the present case, Feldmann, who did not have the rights of a majority holder, bargained for the immediate transfer of Newport's directorate as part of the consideration, knowing that new management was required by the buyers to utilize Newport's steel supply for their own advantage (Findings 65, 84, 65a, 70a). Feldmann admitted that part of what he was paid was for making available the steel supply (105a).

c) Petitioners finally argue that Feldmann was under no duty to refrain from selling his 37%-block of stock;

BLEED THROUGH POOR COPY

that the power to control Newport's output and the selection of its customers was an appurtenant of the control block; and that Feldmann could not transfer his stock without simultaneously transferring that power (Pet., p. 15). These statements may be true as far as they go; but they do not reach the issues in this case.

The power to control the corporation (including the power to control its output and to select its customers) is a "power in trust"; "that power is at all times subject to the equitable limitation that it may not be exercised for the aggrandizement, preference, or advantage of the fiduciary to the exclusion or detriment of the *cestui*" (*Pepper* v. *Litton, supra,* 308 U. S. at 306, 311). Where, as here, the purchaser, to the knowledge of the seller, is committed to a policy of turning this "power in trust" to his private advantage, without regard to the corporate interests, and pays a special premium therefor, the seller is in no better position than if he himself had perverted the power to his private benefit. The sale of the stock, with the appurtenant powers then becomes wrongful; and it is idle for the seller to argue that he could not sell the stock without the power.

POINT II

The decision below rests upon the facts found by the District Court or admitted by petitioners and upon the proper allocation of the burden of proof.

Petitioners impute to the Court of Appeals a holding that the mere fact of a fiduciary's sale of control stock casts upon him the burden of negating corporate injury (Pet., p. 20). The Court of Appeals, it is hardly necessary to say, held nothing of the kind. It did not hold that Feldmann must prove the absence of corporate opportunities. The existence of such opportunities and their diversion by Feldmann was found and amply proved (A-9–A-10).

Petitioners contended below that plaintiffs had not definitely proved that in 1950 Newport could have obtained Feldmann Plan loans, although admittedly Newport had done so in previous years when the shortage was less acute, and other steel producers (to Feldmann's knowledge) were doing so successfully at that time (Findings 37-39, 86, 55a-56a, 71a). It was undisputed, and the District Court found, that Feldmann made no effort whatever in 1950 even to explore the possibilities (Findings 88, 89, 71a), and that "considering the past history of Newport's business and the conditions of the steel market as of then, it is not unreasonable to assume that Newport might have been able in July and August, 1950 to make long range contractual commitments (Finding 81, 69a). The Court of Appeals held that under the circumstances the burden was not upon plaintiffs to prove that a Feldmann Plan transaction could have been successfully effected, but on petitioners to prove the contrary—which they had failed to do (A-10).

BLEED THROUGH POOR COPY

It is beyond question that the rule thus applied was correct. *Pepper* v. *Litton, supra* (308 U. S. at 306).* Petitioners would distinguish this and similar authorities on the ground that they involved transactions between the fiduciary and his corporation, whereas Feldmann's transaction was with third parties. But this is an unwarranted distinction. In the corporate opportunity cases—such as *Irving Trust Co.* v. *Deutsch, supra* (73 F. 2d 121), and *Pratt* v. *Shell Petroleum Corp., supra* (100 F. 2d 833)—the fiduciaries likewise dealt with third parties; a rule similar to, if not stricter than that discussed was nevertheless applied. Whether the fiduciary buys property from his corporation at an inadequate price, or whether by dealing with a third party he diverts a corporate opportunity to himself, he is in either event accountable for his profits, at least where he fails to prove that there was no possibility of corporate harm. This burden petitioners failed to sustain.

Petitioners complain that the Court of Appeals, in remanding the case, gave them no further opportunity to meet that burden. There was no reason to do so. The applicable law has long been settled. In fact, this case was tried by both sides to the hilt, both adducing what evidence they could find on the question of feasibility of Feldmann Plan financing. In the District Court, as in the Court of Appeals, we vigorously argued for the burden of proof rule ultimately adopted by the Court of Appeals. At no time did petitioners suggest to that Court that they had any additional evidence to offer on that issue, nor do they even now say so. Petitioners' contention that a new trial should have been ordered of the very issues so thoroughly ventilated in the District Court is nothing but a belated afterthought.

---

* See also *Schemmel* v. *Hill*, 91 Ind. 373, 169 N. E. 678, 685; *Zaring* v. *Kelly*, 75 Ind. App. 15, 128 N. E. 657, 658; *Mayflower Hotel Stock P. C.* v. *Mayflower Hotel Corp.*, 173 F. 2d 416, 418-423.

2. According to petitioners, the Court of Appeals "assumed" without warrant that the sales price included a premium for the access to Newport's steel (Pet., pp. 21, 23). But the record and the findings clearly show that "the price received by Feldmann and his co-defendants included such a bonus" (A-11).

Feldmann himself admitted that the price was paid for both stock and steel. He testified in so many words that the price was "a combination of both factors, investment value and ability to obtain a source of steel supply" (105a). He admitted that "a purchaser interested only in investment and not interested in securing a source of steel supply" would not have been willing to pay the price (105a). And the District Court held that "where—as here—because of imbalance between supply and demand, the corporation cannot supply all who are eager to become customers, it is obvious, I think, that the power to control the selection of the customers is a factor adding materially to the value of the block of stock to which the power is appurtenant" (Op. 20a).

Feldmann thus commingled in the purchase price the investment value of his stock and a premium for making available Newport's steel supply. Since Feldmann, under the facts of this case, was not entitled to receive payment for making Newport's steel output available to third parties, the burden was upon him as a commingling fiduciary to show how much he should be allowed to retain as the fair value of his stock. Whatever balance remains is the amount of the extra premium for which he must account.

The rule is thoroughly settled that "where there is commingling of gains, he (the wrongdoer) must abide the consequences unless he can make a separation of the profits

BLEED THROUGH POOR COPY

so as to assure to the injured party all that justly belongs to him"; *Sheldon* v. *Metro-Goldwyn Pictures Corp.*, 309 U. S. 390, 406 (1940). Accord: *Bigelow* v. *RKO Radio Pictures*, 327 U. S. 251, 265 (1946); *Hamilton-Brown Shoe Co.* v. *Wolf Brothers & Co.*, 240 U. S. 251, 259-262 (1916). The law of Indiana follows the same rule where a fiduciary in one consideration commingles proper with improper gains; *Brackenridge* v. *Holland*, 2 Black. (Ind.) 377, 383.

The District Court's finding that Feldmann's stock was worth $20 per share was expressly based upon that Court's erroneous theory that Feldmann was entitled to turn the power over the distribution of Newport's product to his own private advantage (Op. 23a). Judge Hincks recognized, however, that the Court of Appeals might take a different view (Op. 30a); and he carefully qualified his finding as to value by adding in Finding 120 (81a):

> "What value the block would have had if shorn of its appurtenant power to control distribution of the corporate product, the evidence does not show."

Since the burden was on Feldmann, as a commingling fiduciary to show how much of the price he received was for what he had a right to sell and how much for diverting Newport's output of steel, the Court of Appeals (on the undisputed evidence) could properly have entered judgment against him for at least $10 per share (see p. 9 *supra*). Instead the Court remanded the case for further hearing on this question, thus giving Feldmann a further opportunity to demonstrate the fair value of his stock as stock.

CONCLUSION

The decision below was interlocutory. Certiorari "is and generally should be issued only after a final decree"; *Panama R. Co.* v. *Napier Shipping Co.*, 166 U. S. 280, 284 (1897). Review of interlocutory decisions is allowed only where "necessary to prevent extraordinary inconvenience and embarrassment in the conduct of the cause"; *American Construction Co.* v. *Jacksonville T. & K. W. R. Co.*, 148 U. S. 372, 384. No such extraordinary circumstances have been shown. On the contrary, if petitioners, as they now contend, can demonstrate upon the accounting that the price they received was no more than the fair value of their stock, there will be no liability and the legal issues will be academic. The application for certiorari is therefore premature.

Nor does the case involve any of the broad questions which petitioners would seek to present to this Court. The decision below rests, not on the sweeping generalities which petitioners would impute to the Court of Appeals, but on the application of familiar principles of fiduciary law to the particular facts of this case.

It is respectfully submitted that the petition for a writ of certiorari should be denied.

Dated: New York, N. Y., May 22, 1955.

Respectfully submitted,

EUGENE EISENMANN
11 Broadway
New York City, N. Y.

WILLIAM E. HAUDEK
295 Madison Avenue
New York City, N. Y.
Attorneys for Respondents

POMERANTZ LEVY & HAUDEK,
General Counsel for Respondents

PROSKAUER ROSE GOETZ & MENDELSOHN,
Appellate Counsel for Respondents